

VZCZCXRO0961

OO RUEHAG RUEHAST RUEHBI RUEHCI RUEHDA RUEHDF RUEHFL RUEHIK RUEHKW
RUEHLA RUEHLH RUEHLN RUEHLZ RUEHPOD RUEHPW RUEHROV RUEHSR RUEHVK
RUEHYG

DE RUEHTA #2086/01 2960422

ZNR UUUUU ZZH

O 220422Z OCT 08

FM AMEMBASSY ASTANA

TO RUEHC/SECSTATE WASHDC IMMEDIATE 3614

INFO RUCNCIS/CIS COLLECTIVE 0704

RUCNCLS/SOUTH AND CENTRAL ASIA COLLECTIVE

RUEHZL/EUROPEAN POLITICAL COLLECTIVE

RUEHBJ/AMEMBASSY BEIJING 0105

RUEHKO/AMEMBASSY TOKYO 0815

RUEHIT/AMCONSUL ISTANBUL 0039

RUEHBS/USEU BRUSSELS

RUEHVEN/USMISSION USOSCE 1989

RUCNDT/USMISSION USUN NEW YORK 1938

RUEHNO/USMISSION USNATO 2274

RHEBAAA/DEPT OF ENERGY WASHDC

RUCPDOG/DEPT OF COMMERCE WASHDC

RUEATRS/DEPT OF TREASURY WASHDC

RUEAIIA/CIA WASHDC

RHEFAAA/DIA WASHDC

RHEHNSC/NSC WASHDC 0261

RUEKJCS/SECDEF WASHDC 0183

RUEKJCS/JOINT STAFF WASHDC

RHMFUU/CDR USCENTCOM MACDILL AFB FL

UNCLAS SECTION 01 OF 02 ASTANA 002086

SENSITIVE

SIPDIS

STATE FOR SCA/CEN, EEB

E.O. 12958: N/A

TAGS: [PGOV](#) [EPET](#) [EINV](#) [ENRG](#) [KG](#) [KZ](#)

SUBJECT: KAZAKHSTAN: AES SUCCESS TEMPERED BY CONCERNS OVER PRICE
REGULATION

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On October 9, AES Country Manager Mike Jonagan briefed the Ambassador on the history of AES's investments in Kazakhstan's power sector, outlined a proposed solution to pending anti-monopoly charges, and expressed concern about a new draft decree that would impose strict price controls on retail power companies. END SUMMARY.

A SOLID RETURN ON EKIBASTUZ

13. (SBU) Jonagan began the meeting on an upbeat note, explaining to the Ambassador that AES sold its ownership in Ekibastuz, a 4,000 MW thermal coal-fired power station in northeastern Kazakhstan, for \$1.3 billion to Kazakhmys in May 2008, a significant return on their \$3.5 million investment in 1997. (NOTE: Kazakhmys is a UK-registered copper mining company majority-owned by Kazakhstani billionaire Vladimir Kim. END NOTE). Jonagan characterized the transaction as straightforward, with relatively few complications: "We never asked them for anything else and they never asked us for anything." He described how AES's investments over the years helped to modernize the plant's infrastructure, expand its generating capacity, and pay off all debt. Jonagan also noted the importance of a 15-year contract to provide 300 MW of electricity to Russia off the Russian grid and described how AES and its customers and suppliers -- including the railroad, water canal, and coal mine -- made the transition from a barter system to cash payments.

14. (SBU) Jonagan told the Ambassador that, over time, "we got the message" that the Government of Kazakhstan wanted Ekibastuz in Kazakhstani hands. He also confided that AES had reached a crossroads with Ekibastuz earlier this year: they had to decide whether to invest an additional \$1 billion to bring the plant up to full capacity, which would make the business worth approximately \$3 billion, or sell the company and realize a significant return on their initial investment. AES does not typically disclose the relative value of individual assets, but Jonagan told the Ambassador

that at \$3 billion, Ekibastuz would have represented approximately 25% of the company's total equity, which some company insiders felt would create an imbalance in their portfolio. Jonagan said AES had no regrets about its decision to sell Ekibastuz and proudly noted that the Government retained AES to operate the plant under a management agreement until December 2010. "They know that we can add value in terms of safety, environmental protection, transparency, and procurement," he said.

15. (SBU) Simultaneously, AES has developed what Jonagan called a "world-class power distribution business" in eastern Kazakhstan. During the past four years, AES has improved collection rates even as tariffs have risen and has steadily paid down the company's debts. The biggest challenge with that business, according to Jonagan, is overcoming the old Soviet mentality and culture that encouraged customers to treat electric power as an entitlement. Jonagan recounted how an elderly woman, a veteran of World War II, scolded him for trying to collect money from her. "I fought the fascists," she said. "Stalin promised me free electricity and I'll never pay."

ANTI-MONOPOLY ALLEGATIONS

16. (SBU) Turning to the ongoing dispute over a \$200 million fine for alleged antimonopoly activities, Jonagan expressed optimism that a settlement was within reach. (NOTE: AES has already paid \$29 million of the fine and has had another \$6.5 million in assets frozen. END NOTE). According to Jonagan, on September 5, the Ministry of Finance presented AES with 12 items that it said needed to be resolved or changed in its current contractual arrangement. AES has no objections to any of the items in principle, but each one has a commercial value that must be calculated and incorporated into

ASTANA 00002086 002 OF 002

a new "term sheet" (i.e., a new contract.) Jonagan speculated that one way out of the impasse would be for a Ministry of Finance-led working group to develop a new term sheet that would address the 12 items raised by the Government of Kazakhstan, followed by a Supreme Court decision that all previous lower court decisions against AES are invalid due to "technical deficiencies," at which point the lower court would drop the case against AES. Jonagan seemed confident this would work and said the head of the Supreme Court told him, "We've got to figure out how to get out of this situation."

"NOW WE'RE REALLY STUMPED"

17. (SBU) On September 17, AES and other power companies were invited to a meeting chaired by Minister of Energy and Mineral Resources Sauat Mynbayev to discuss electricity tariff policy to 2015. At the meeting, Mynbayev distributed a draft decree from Prime Minister Masimov "to enhance the investment attractiveness of the electric power industry and ensure the development of power assets" in Kazakhstan. The decree, which has not yet come into effect, calls upon the Ministry of Energy and Mineral Resources (MEMR), the Ministry of Economy, and the Agency for the Regulation of Natural Monopolies to set tariff ceilings by December 1, 2008 for electric, thermal, hydroelectric, and gas-turbine power generation up to 2015.

18. (SBU) The decree would fix hydroelectric power increases at 107% of current tariffs for the next seven years. As Jonagan put it, "our assigned price is ridiculous." Jonagan also confided that MEMR suggested the possibility of charging one set of clients a higher price than other clients (with poorer residential customers presumably getting the lower rates). He called this a violation of the terms of the contract and asked rhetorically, "How do I decide who gets the cheap electricity?" He informed the Ambassador that AES has retained legal counsel and is looking into the possibility of international arbitration to settle the matter. Jonagan lamented the fact that, just as AES seemed about to resolve its anti-monopoly allegations, another new problem had appeared. "Now we're really stumped," he said.

AES INTERESTED IN KYRGYZ ASSETS

19. (SBU) Jonagan told the Ambassador that AES had previously been encouraged by the Government of Kyrgyzstan to submit a proposal to acquire state-owned power companies, but was told very recently by Kyrgyz officials that Russian President Medvedev has put pressure on the Government of Kyrgyzstan to sell its power assets to a Russian company, Inter RAO. Jonagan said that AES would be willing to allow Inter RAO to buy the hydroelectric plants, but AES is keenly interested in Kyrgyzstan's combined heat and power assets. The Ambassador urged Jonagan to provide this information to the Embassy in Bishkek and the U.S. Foreign Commercial Service.

HOAGLAND